

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Dunn Analyst: Jeani Brent Bill Number: SB 2200

Related Bills: See Legislative History Telephone: 845-3410 Introduced Date: 03/20/2000

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Research Expenses Credit/Increase to 17% and 30% of Excess Expenses/FTB Report Credit Usage On Internet

SUMMARY

This bill would do the following:

- Ⓟ Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would increase the state research credit for "qualified research expenses" from 12% to 17%.
- Ⓟ Under the B&CTL, this bill would increase the state research credit for "university basic research" from 24% to 30% of qualified payments.
- Ⓟ Under the Administration of Franchise and Income Tax Laws (AFITL), this bill would require specified corporate taxpayers that claim the research credit to provide the department with specified information regarding the credit and the taxpayer's employees, their wages and health benefits. This bill would require the department to publish the information provided by each taxpayer, including the corporation name.

The increased credit percentages and the reporting requirements will be addressed separately in this analysis.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable and income years beginning on or after January 1, 2000.

BOARD POSITION

Pending.

ISSUE #1: RESEARCH CREDIT

LEGISLATIVE HISTORY

AB 1953 (2000), AB 2592 (2000), and SB 1492 (2000) would increase the qualified research expenses credit percentage and would decrease the minimum threshold for computing the credit.

AB 465 (1999/2000) would increase the alternative incremental research expenses credit to 100% of the federal amount.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Alan Hunter for GHG

4/13/00

SB 705 (Stats. 1999, Ch. 77) increased the state credit for "qualified research expenses" from 11% to 12%.

AB 68 (1999) would have increased the qualified research expenses credit percentage and would have decreased the minimum threshold. AB 68 failed to pass out of the first house by January 31 of the second year of the session.

SPECIFIC FINDINGS

Existing federal law provides for a research tax credit equal to 20% of the excess of a taxpayer's "qualified research expenses" for a taxable year over its base amount for that year.

A 20% research tax credit also is allowed for the excess of (1) 100% of corporate cash expenditures (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the "university basic research" credit.

Except for certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding taxable years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three taxable years from 1984 through 1988, then its "fixed-base percentage" is the percentage that its total qualified research expenditures for the 1984-1988 period is of its total gross receipts for that period (subject to a maximum percentage of 16%). All other taxpayers, including any firm that had both gross receipts and qualified research expenses in the first taxable year beginning after 1983 (so-called "start-up firms"), are assigned a fixed-base percentage of 3%. In computing the credit, a taxpayer's base amount may not be less than 50% of its current-year qualified research expenditures.

Expenditures attributable to research conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

Existing state law conforms with specific modifications to the federal research credit, including modifications to the credit percentage amounts. The state credit percentage is 12% for "qualified research" and 24% for corporations for "university basic research." To duplicate the federal provision that allows the credit for "university basic research" payments only to corporate taxpayers, the B&CTL allows the credit based on "qualified research" expenses and "university basic research" payments, while the PITL allows the credit only for "qualified research expenses."

This bill would increase the state credit for "qualified research expenses" from 12% to 17% and would increase the "university basic research" percentage of the credit from 24% to 30%.

Implementation Considerations

Implementing this credit provision would occur during the department's normal annual system update.

FISCAL IMPACT

Departmental Costs

This credit provision would not significantly impact the department's costs.

Tax Revenue Estimate

The revenue impact of this credit provision is estimated to be revenue losses as shown below:

Revenue Impact of SB 2200 Research Credit Provision Assumed Enacted after 6/30/2000			
Losses in \$ Millions			
2000-01	2001-02	2002-03	2003-04
-\$37	-\$60	-\$73	-\$79

This estimate does not account for changes in employment, personal income, or gross state product that could result from this measure.

Revenue Estimate Discussion

The revenue impact of this credit provision is estimated in the following manner. The research credits generated under current and proposed laws are simulated for each corporation in a sample of the 50 corporations with the largest research and development expenses. These simulations take into account specific micro-economic data for each corporation such as gross receipts, wage, property, and sales factors, net income, historical research expenditures, and detailed tax and financial data. The results of the simulations are weighted statistically to the population level. The revenue losses are estimated as the differences between the taxes simulated under current and proposed laws. The Department of Finance forecast of corporate profits is used to extrapolate the estimates to future years.

Revenue impact for the PITL is assumed to be equal to 5% of the B&CTL impact and is added to the corporate impact.

ISSUE # 2: TAXPAYERS PROVIDE AND FTB TO PROVIDE INFORMATION TO LEGISLATURE AND PUBLISH ON WEBSITE

LEGISLATIVE HISTORY

AB 1220 (1999) contains essentially the same reporting requirement as provided in this bill; currently in Senate Revenue and Taxation Committee.

AB 797 (Stats. 1997, Ch. 461) requires the department annually to make available to the Trade and Commerce Agency and the Legislature information on the dollar value of the enterprise zone tax credits claimed each year.

In March of 1995, Governor Wilson issued an executive order requiring all state agencies to provide public information on the Internet.

SPECIFIC FINDINGS

Existing state law prohibits the disclosure of any information concerning any taxpayer by the department, except as specifically authorized by statute. Any department employee or member could face a criminal misdemeanor charge for release of confidential state tax information and a felony charge for release of confidential federal tax information.

Under existing state law, all information on an individual personal income tax return is confidential. For corporate returns, all information on a return is confidential, except "extraneous matters," identified in the code as such items as the exact corporate title, corporate number, the date of the commencement of business in this state, taxable year adopted, filing date of return, name, date and title of individuals signing affidavit to the return, due date of the taxes, taxes unpaid, entity's address, private address of officers and directors. Extraneous matters, however, may be disclosed only in response to a request regarding a named entity and only if there is no reason to believe that the information will be used for commercial list purposes.

Existing state law, in limited instances, permits the department to release tax return information to certain state agencies, such as legislative committees, the Attorney General, the California Parent Locator Service, the directors of Social Services and Health Services, and California tax officials, such as the Board of Equalization, the Employment Development Department, the State Controller, and the Department of Motor Vehicles. State agencies must have a specific reason for requesting the information, i.e., tax investigation, verifying eligibility for public assistance, locating absent parents to collect child support, or locating abducted children. For some agencies, only limited information may be released, such as the taxpayer's social security number and address.

Existing state law permits the department to release tax return information according to tax return sharing agreements with the IRS, the Multistate Tax Commission (MTC), and taxing authorities of other states. The exchange must relate to the enforcement of tax laws, and the information must not be made public. Shared information includes sales tax, income tax, and corporation tax return data. The tax return information relating to multi-state and multi-national tax audits is shared with the MTC.

This bill would require corporate taxpayers with gross receipts, less returns and allowances, of \$5 million or more that claim a research credit in an amount representing the increase proposed by this bill to provide the department with the following specified information related to the taxpayer's trade or business activities in California:

1. Taxpayer's name
2. Amount of research credit and carryover claimed
3. Number of full-time equivalent employees
4. Median weekly wage or salary paid to nonsupervisory employees
5. Percentage of nonsupervisory employees for which the taxpayer pays at least 80% of the health or medical insurance premiums.

The information would be required to be included with the taxpayer's original return for each income year.

This bill would impose a penalty of an unspecified amount on taxpayers that fail to file specified information with their returns, unless the taxpayer complies within 90 days after notice and demand by the department. Taxpayers that fail to comply also would be specifically denied the credit and carryover claimed in that income year.

This bill would require the department to publish the information provided by each corporation, including the corporation name. The bill would require the information also to be provided to the Legislature and the public in a manner determined by the department, including being published on the department's website.

This bill would permit an exception to the general rule that it is a misdemeanor for any departmental employee to release confidential state tax information for the information required to be published and provided to the Legislature under this bill.

Policy Considerations

California has a self-assessed tax system that relies on the responsiveness of taxpayers to report the proper tax. A self-assessed tax system works only if taxpayers have confidence that the information will be confidential and used only for the specified purpose. If tax information is used or disclosed for other than the specified purpose, the effectiveness of the state's self-assessed tax system may be diluted.

The reporting requirements in this bill would not apply to taxpayers who claim the specified credits under the Personal Income Tax Law (S corporation shareholders, partners, and sole proprietors).

Implementation Considerations

The reporting requirement in this bill would be limited to those corporate taxpayers that claim a research credit for the increased amount provided by the bill. This provision could have varying interpretations. One interpretation would be that a corporate taxpayer could avoid being subject to the reporting requirement by claiming a research credit in the amounts authorized by the law in effect before the bill. However, a credit in the reduced amount would no longer be authorized under the code.

Alternatively, since the credit language does not appear to provide taxpayers the option to claim their research credit using a smaller or different amount than that specified in this bill, it could be interpreted that any taxpayer claiming the credit must both claim the increased amount and must comply with the reporting requirement. The bill should be amended to clarify the author's intent on this issue.

Technical Considerations

The reporting requirement would apply only to taxpayers subject to the B&CTL. Accordingly, unless the bill is intended to also impose the reporting requirement on non-corporate taxpayers, it is unnecessary to reference the research credit under the Personal Income Tax Law. The attached amendments would delete those references.

LEGISLATIVELY MANDATED REPORTS

This bill would require the department to report to the Legislature and the public annually and to place on the Internet specified information for each income year.

FISCAL IMPACT

Departmental Costs

Staff preliminarily estimates that the order of magnitude of the departmental costs would be as shown in the following table:

Franchise Tax Board Order of Magnitude Costs for SB 2200 As Introduced March 20, 2000 (in millions)		
	2000/01	2000/02
Personal Services (approximately 27 personnel years)	0.9	0.9
Operating Expense and Equipment	0.7	0.2
Departmental overhead	0.1	0.1
Total	\$ 1.7	\$ 1.2

This analysis does not take into account all of the facilities and related costs that might be incurred to create space for the special unit that would be created. These costs have the potential of significantly increasing the costs identified in this analysis.

The estimates shown above are the same as the estimates for AB 1220 (1999). The reporting requirement in this bill impacts taxpayers claiming only one credit as opposed to AB 1220, which would have impacted taxpayers claiming any of several credits. However, the department's assumptions remain the same and costs are not variable because fewer credits are impacted. The major source of the cost is the fact that, no matter how many credits are impacted, the department still would have to manually process all corporate returns to identify the returns that have claimed the credit and to identify whether those taxpayers have complied with the reporting requirement.

Tax Revenue Estimate

This information provision would not impact the state's income tax revenue.

Analyst	Jeani Brent
Telephone #	845-3410
Attorney	Patrick Kusiak

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 2200
As Introduced March 20, 2000

AMENDMENT 1

On page 5, line 27, strikeout "Sections 17052.12 and" and insert:

Section

AMENDMENT 2

On page 5, line 32, strikeout "17052.12 or".